

502 DEVELOPMENT COST ESCROW (DCE) POLICY

This policy provides guidance regarding the Development Cost Escrow accounts and distribution of funds from those accounts. The following topics will be covered:

Purpose of Development Cost Escrow

Contributions to DCE Accounts

Eligible Expenses

Requests for DCE Disbursement

MSHDA Processing of DCE Requests

Loan Default or Recapture Obligation Event

Discharge of the Mortgage Loan

Purpose of Development Cost Escrow

Development Cost Escrow (DCE) Principal - This account is held by MSHDA and is intended for funding amenities or design modifications, which will increase the value of the development. In certain cases, the DCE principal account may assist with the payment of operational expenses.

DCE Interest – This account is held by MSHDA and may be used as funding for operational expenses in a similar manner as surplus cash and the Operating Reserve Cash (ORC) account.

Contributions to DCE accounts

DCE Principal - The initial contribution was funded from a portion of the mortgage loan proceeds.

DCE Interest – Contributions come from interest earned on the ongoing investment of DCE principal and accumulated DCE interest funds.

Funds on deposit in the DCE accounts are invested by the Authority's Finance division and remain in control of the Authority until disbursement. Interest earned on the funds deposited in the DCE accounts, if any, accumulate in the DCE interest account and are treated in a similar manner as ORC funds.

Eligible Expenses

DCE Principal – With approval from MSHDA's Asset Management (AM) division, DCE principal funds may be used to pay for:

1. Development amenities or design modifications, which provide:
 - Necessary or desirable improvements for marketing the development;
 - Reduction in the maintenance costs over a substantial portion of the mortgage term;
 - Benefits to a substantial percentage of the residents of the development by providing necessary or desirable social services that may improve health, educational opportunities, security and/or general welfare of such residents;
 - Important contributions to the livability of the development.
2. Operational expenses which maintain the fiscal and physical integrity of the development after other available funding sources have been exhausted.

DCE Interest – May be used to pay for development operating expenses based on the priority set forth in the Management Agreement under Section 5 – Expense Management. Eligible expenses include:

- Payments to maintain the fiscal and physical integrity of the development;
- Expenses/payables projected to come due without operating funds being available in the next 30 days, and;
- Limited Distribution payments as permitted by the development’s Regulatory Agreement.

Requests for DCE Accounts Disbursement

DCE Principal – When the Owner/Agent is considering an amenity or design modification to a development, the Owner/Agent should initiate contact with the assigned Asset Manager who will help coordinate a meeting with one of the AM Construction Analyst staff members. The Construction Analyst will facilitate the exchange of ideas about the development’s purpose for improvement and the Authority’s interests in verifying that the desired modification meets the intended goals and design standards.

After this communication, the Owner/Agent should be able to proceed forward with capturing bids for the pre-approval process. Refer to the Replacement Reserve Policy – Bid Information for details regarding capturing the necessary bid information and submitting bids for pre-approval. Pre-approvals are required for all amenity or design modifications when the Owner/Agent plans to use DCE Principal funds. Upon receipt of the pre-approval of the amenity or design modification from the AM Construction Analyst, the Owner/Agent may begin the construction process.

Upon completion of the work, the Owner/Agent may submit a written request to disburse funds from the DCE Principal account for eligible expenses. Typically the funds will not be disbursed until the work invoices are submitted, but other payment arrangements may be negotiated with AM division. For example, if a contractor would like partial payment to begin the construction process and no other funds are available to place the down payment, DCE principal funds may be used. Requests for DCE principal disbursement must include the following:

- An explanation of the intended use of the funds;
- The pre-approval letter;
- The amount of the request;
- Evidence of the current cash position of the development. Owner/Agent should verify there are no other eligible funds to use for the expense.

DCE Interest - The Owner/Agent must submit a written request for DCE Interest disbursement to the assigned Asset Manager in order to receive DCE Interest funds. The request must include the following:

- An explanation of the intended use of the funds;
- Evidence of the current cash position of the development, allowing for one month's Gross Rent Potential on-site;
- The amount of the request, which must exceed \$1000.

MSHDA Processing of DCE Requests

The assigned Asset Manager verifies that the draw meets the eligibility and financial requirements and has 14 days to perform his/her review. An additional 14 days is allowed for managerial review and processing through MSHDA's Finance division. If all the required information is submitted with the request, the disbursement should be processed within 30 days of receipt by MSHDA.

DCE Principal – Upon receipt of the DCE Principal request, the assigned Asset Manager will review the development's letter of pre-approval, financial eligibility, and explanation in order to approve the request.

1. Pre-approval request – Verify the pre-approval:
 - a. Has been signed by the AM Construction Analyst;
 - b. Covers the same items completed and requiring payment from the DCE Principal account.
2. Liquidity of the development
 - a. *Liquidity Calculation*: $\text{Liquidity} = \text{Operating Cash} + \text{Receivables} - \text{Payables}$, including Prepaid Rent + ORC balance. Refer to the Operating Reserve Cash Policy for a more detailed calculation of development liquidity.
 - b. Are the requested items included in the Capital Needs Assessment or typically a Replacement Reserve eligible item?
 - c. Can the development fund the request through other sources of funds?
 - d. Does using other available funding make better sense for the development's financial status?
3. Explanation regarding how the funds will be used. The fund will pay for a(n):
 - a. Necessary or desirable improvement toward marketing the development;

- b. Reduction in the maintenance costs over a substantial portion of the mortgage term;
- c. Benefit to a substantial percentage of the residents of the development by providing necessary or desirable social services that may improve health, educational opportunities, security and/or general welfare of such residents;
- d. Important contribution to the livability of the development;
- e. Operating expense that provides an **operating benefit** to the development and for which the development does not have the money on-site to support.

DCE Interest - Upon receipt of the request, the assigned Asset Manager will review the development's financial eligibility for approval of the DCE Interest request. The following items shall be considered:

1. Liquidity of the development – The development can maintain up to one month's Gross Rent Potential (GRP) in the development's on-site operating account.

Calculation to bring Operating Cash up to One Month's GRP:

Amount to be processed = One month's GRP – (Operating Cash + Receivables – Vendor payables).

2. Explanation regarding how the funds will be used. The fund will:
 - a. Pay for operating expenses that provide an **operating benefit** to the development and for which the development does not have the money on-site to support.
 - b. Pay Escrow account shortages, such as tax and insurance deficits or replacement reserve needs.
 - c. Bring the on-site operating cash up to one month's GRP.
 - d. Pay a limited distribution request as permitted by the development's Regulatory Agreement and designated as a source of funds by the limited distribution approval from MSHDA.

Loan Default or Recapture Obligation Events

In the event of that the Mortgage Loan, NSP Loan, HOME Loan, TCAP or other MSHDA held mortgage note is accelerated after a default by the Mortgagor, or the Mortgagor becomes liable for a Recapture Obligation, the Authority may, in its sole discretion, but is not required to, apply any funds on deposit in the DCE Principal and Interest accounts to the amount due on the loan or to satisfy the Recapture Obligation unless otherwise stated in the Regulatory Agreement.

Discharge of the Mortgage Loan

Upon payment in full and discharge of the Mortgage Loan, a thorough review of the Notes and Regulatory Agreements will provide the specific requirements for the loan, but in general:

DCE Principal – This account is closed and the funds disbursed to the Mortgagor unless otherwise stated in the Regulatory Agreement.

DCE Interest - This account is closed and any balance remaining after the Mortgagor receives all permissible Limited Dividend payments shall be paid to the Authority.